

**STATE OF CALIFORNIA  
DEPARTMENT OF INSURANCE  
45 Fremont Street, 24th Floor  
San Francisco, California 94105**

**NOTICE OF PROPOSED ACTION**

**DATE: August 21, 2009**

**REGULATION FILE: REG-2009-00019**

**SUBJECT OF PROPOSED RULEMAKING**

The Insurance Commissioner proposes to adopt the regulation described below after considering comments from the public. The Commissioner proposes to add to Title 10, Chapter 5, Subchapter 1, of the California Code of Regulations a new article 14 "Underwritten Title Companies" and a new section 2194.70 entitled "Underwritten Title Company Limitation on Liability." The proposed regulations will promote the regulation of the business of title insurance, govern the conduct of underwritten title companies and will implement and effect compliance by the title industry with the Underwritten Title Company statute of the Insurance Code commencing with Insurance Code section 12389 and other related statutes.

**PUBLIC HEARING**

The Commissioner will hold a public hearing to provide all interested persons an opportunity to present statements or arguments, either orally or in writing, with respect to this regulation, as follows:

**Date and time: Monday, October 5, 2009 at 1:00 p.m.**

**Location: Department of Insurance  
Administrative Hearing Bureau Hearing Room  
45 Fremont Street, 22nd Floor  
San Francisco CA 94105**

The hearing will continue on the date noted above until all testimony has been submitted or 4:00 p.m., whichever is earlier.

**PRESENTATION OF WRITTEN COMMENTS; CONTACT PERSONS**

All persons are invited to submit written comments on the proposed regulations during the public comment period. The public comment period will end at 5:00 p.m. on October 5, 2009. Please direct all written comments to the following contact person:

Jill Alexis Jacobi  
Senior Staff Counsel  
California Department of Insurance

45 Fremont Street, 24th Floor  
San Francisco, CA 94105  
Telephone: (415) 538-4426

Questions regarding procedure, comments, or the substance of the proposed action should be addressed to the above contact person. In the event the contact person is unavailable, inquiries regarding the proposed action may be directed to the following backup contact person:

Arnold Kessler  
Senior Staff Counsel  
California Department of Insurance  
45 Fremont Street, 24th Floor  
San Francisco, CA 94105  
Telephone: (415) 538- 4157

## **DEADLINE FOR WRITTEN COMMENTS**

All written materials must be received by the Insurance Commissioner, addressed to the contact persons at his address listed above, no later than 5:00 p.m. on October 5, 2009. Any written materials received after that time may not be considered.

## **COMMENTS TRANSMITTED BY E-MAIL OR FACSIMILE**

The Commissioner will accept written comments transmitted by e-mail provided they are sent to the following e-mail address: [JacobiJ@insurance.ca.gov](mailto:JacobiJ@insurance.ca.gov). The Commissioner will also accept written comments transmitted by facsimile that are ten pages or less and are directed to the attention of Jill Jacobi and sent to the following facsimile number: (415) 904-5729. **Comments sent to other e-mail addresses or other facsimile numbers will not be accepted. Comments sent by e-mail or facsimile are subject to the deadline set forth above for written comments.**

## **AUTHORITY AND REFERENCE**

The proposed regulations will implement, interpret and make specific the provisions of Insurance Code sections 533, 700, 717, 720, 12389, 12389.1, 12389.2, 12389.5, 12389.6 and 12921. Insurance Code sections 720, 12389, and 12921 provide authority for this rulemaking, as do the following decisions *CalFarm Ins. Co. v. Deukmejian*, 48 Cal.3d 805 (1989), *20th Century Ins. Co. v. Garamendi*, 8 Cal. 4th 216 (1994), *McHugh v. Santa Monica Rent Control Board*, 49 Cal. 3d 348 (1989) and *George v. Department of Alcoholic Beverage Control*, 149 Cal.App.2d 702 (1957).

## **INFORMATIVE DIGEST**

## **SUMMARY OF EXISTING LAW AND POLICY STATEMENT OVERVIEW**

Commencing in 1973, the California legislature enacted article 3.7 of Chapter 1 Title Insurance, Part 6, Division 2 of the Insurance Code, in pertinent parts Insurance Code sections 12389,

12389.1, 12389.2, 12389.4, 12389.5 and 12389.6, entitled “Underwritten Title Companies.” Underwritten title companies are California corporations licensed for the purpose of preparing title searches, title examinations, title reports and certificates of abstracts of title upon which a title insurer writes title insurance policies. *See* Insurance Code § 12389.5. Underwritten title companies may also be licensed to perform title related escrow services. *See* Insurance Code § 12389 (b). Underwritten title companies may only perform escrow services and title insurance related services pursuant to contractual arrangements with one or more title insurers; these contractual arrangements are generally known as underwriting agreements. *See* Insurance Code § 12389.6. The minimum financial requirements for licensure of underwritten title companies are established by counties of licensure and are generally lower than those of title insurers. *See* Insurance Code § 12389 (a) (2).

Title insurers are insurance companies who write policies that indemnify, insure or guarantee the owners of property for loss or damage resulting from incorrectness of searches related to property title, liens or encumbrances on or defects in title and the invalidity or unenforceability thereof and are required by law to be admitted (licensed) for class four title insurance. *See* Insurance Code §§ 104, 700. Title insurers may write policies upon searches performed by underwritten title companies, or they may transact title business on their own as direct writers. The policies that the title insurers write obligate the title insurers to pay claims; underwritten title companies may contract in their underwriting agreement to pay claims *on behalf of the title insurer*. *See* California Code of Regulations Title 10 sections 2695.1 and 2695.2 (i), (j) and (m) (*emphasis added*). The minimum financial requirements for admission (licensure) of title insurance companies are statewide and are generally higher than those of underwritten title companies. *See* Insurance Code §§12359 and 12370.

The California title marketplace is highly concentrated with a dozen or so title insurers currently licensed and operating. These title insurers are in a superior economic position to their agent underwritten title companies and, given the unequal bargaining power between these entities’ provisions in underwriting agreements are often not the result of arms length negotiations and may financially disfavor and disadvantage the underwritten title companies. Inequities in the underwriting agreement provisions pertaining to indemnification and risk transfer between title insurers and underwritten title companies are not consistent with regulatory efforts to limit such transfers of liability to the smaller, less capitalized underwritten title companies.

For at least the past twenty years, the California Department of Insurance (“CDI”) has limited the exposure of underwritten title company losses in underwriting agreements with their title insurers to a maximum of five thousand dollars (\$5,000), although no regulation has ever been promulgated to implement this longstanding rule. Promulgation of this proposed title regulation is intended to continue the existing, long standing CDI position limiting the contractual shifting of responsibility for losses between title insurers and their underwritten title company agents to five thousand dollars (\$5,000) per policy. Further, the CDI has over the years, consistent with California law permitted exceptions for intentional or willful acts and escrow related losses, which exceptions are also to be included in the proposed regulation. *See* Insurance Code section 533.

The allocation or responsibility and agency relationship between title insurers and underwritten title companies is discussed by the California Supreme court in *Title Insurance Company of Minnesota v. State Board of Equalization* (1992) 4 Cal 4<sup>th</sup> 715, 14 Cal.Rptr 2d. 822

“the [title] insurers issue all or some of their title policies through underwritten title companies (sometimes referred to hereafter as “title companies”). Pursuant to a written underwriting agreement with the title insurer, to which those seeking title insurance are not a party, the underwritten title company conducts a title search and examination and prepares a preliminary title report on the conditions under which title insurance would be available. *Acting as the title insurer’s agent*, the underwritten title company issues the title insurance policy...”

*Id.* at 720, Cal.Rptr at 824 (stipulated facts, *emphasis added*).

The California Supreme Court found there were inconsistencies in the indemnification or risk shifting arrangements between the various title insurers and underwritten title companies in their underwriting agreements. *Id.* The proposed regulation will eliminate those inconsistencies. Pursuant to Insurance Code section 12389 “Authority,” the Commissioner of Insurance may promulgate reasonable rules and regulations to govern the conduct of business of underwritten title companies.

The purpose of the proposed action is to enact a long standing position of the California Department of Insurance (“CDI”) to limit the liability of underwritten title companies to indemnify title insurers to five thousand dollars (\$5,000) with some specific exceptions for intentional, willful acts and escrow related losses, which limitation fosters the solvency of underwritten title companies. Further, the proposed action limits the liability that may be transferred from the title insurer, that is generally more highly capitalized and able to bear the loss, to the underwritten title company agent that is generally less able to bear the loss. Furthermore, to the extent that shifting of liability to the underwritten companies is not limited, a commensurate increase in their capitalization would be required for initial licensing and expansion, thus diminishing market entrance and small business formation and growth within the state. The proposed action also creates an incentive for underwritten title companies to use a duty of care by permitting the transfer of some risk to underwritten title companies.

Towards the achievement of that goal, the proposed regulation establishes the limitations on risk transfer between title insurers and underwritten title companies that may be agreed to by contract. The purposes of Insurance Code section 12389 are to maintain the solvency of underwritten title companies and to protect the public by preventing fraud and requiring fair dealing. The proposed regulation is a reasonable rule to govern the conduct of underwritten title companies that are subject to Insurance Code section 12389.

## **EFFECT OF PROPOSED ACTION**

The proposed regulations should maintain the status quo for many title insurers and underwritten title companies who have limited their risk transfers to the longstanding five thousand dollar (\$5,000) limitation. The proposed regulations may have the effect of requiring other title insurers and the underwritten title companies to modify their contractual arrangements to limit the indemnification or transfer of liability to five thousand dollars (\$5,000) with specified exceptions.

The proposed new regulation sets forth the authority pursuant to which they are to be promulgated and will be immediately effective upon adoption. This new section clarifies and makes specific the rule that will govern the conduct of business of underwritten title companies and their title insurers.

The proposed new regulation defines the terms “loss” and “contract” as reasonably necessary to make specific the provisions of Insurance Code section 12389. By defining these terms the new proposed regulation will clarify and provide a consistent application of the proposed regulation. An express definition of these terms in the proposed section should facilitate compliance by underwritten title companies with Insurance Code sections 12389 and 12389.1 and should also facilitate solvency of the underwritten title companies. The proposed regulations should also eliminate confusion that may exist as to the amount of indemnification or risk that may be transferred by title insurers to underwritten title companies.

## **MANDATES ON LOCAL AGENCIES OR SCHOOL DISTRICTS**

The proposed regulations do not impose any mandate on local agencies or school districts. There are no costs to local agencies or school districts for which Part 7 (commencing with Section 17500) of Division 4 of the Government Code would require reimbursement.

## **COST OR SAVINGS TO STATE AGENCIES, LOCAL AGENCIES OR SCHOOL DISTRICTS OR IN FEDERAL FUNDING**

The Commissioner has determined that the proposed regulations will result in no cost or savings to any state agency, no cost to any local agency or school district that is required to be reimbursed under Part 7 (commencing with Section 17500) of Division 4 of the Government Code, no other nondiscretionary cost or savings imposed on local agencies, and no cost or savings in federal funding to the State.

## **ECONOMIC IMPACT ON BUSINESS AND THE ABILITY OF CALIFORNIA BUSINESSES TO COMPETE**

The Commissioner has made an initial determination that the adoption of the proposed regulation will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

## **POTENTIAL COST IMPACT ON PRIVATE PERSONS OR BUSINESSES**

The proposed regulations implement existing regulatory requirements; therefore the proposed regulations may, but should not have a significant impact on many of the title businesses currently operating in California. The Commissioner is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action. The proposed regulations could require some title insurers and underwritten title companies to amend their existing underwriting agreements to limit the liability transferred. Some title insurers and underwritten title companies may need to develop new business risk assessments, or may need to re-engineer their businesses plans to comply with these regulations. We estimate that up front business costs for compliance with these regulations could cost these companies up to ten thousand dollars \$10,000 (e.g., costs of actuarial consultants, legal advice, *etc.*) while ongoing costs associated with compliance should be offset by other contractual arrangements.

## **EFFECT ON JOBS AND BUSINESSES IN CALIFORNIA**

The Commissioner is required to assess any impact the regulations may have on the creation or elimination of jobs in the State of California, the creation of new businesses, the elimination of new businesses, and the expansion of businesses currently operating in the state.

The proposed regulations implement existing statutes and should not have a significant impact on jobs and formation of new business in California. It is possible and certainly anticipated that the proposed action could have an overall neutral or positive impact on jobs and businesses in California to the extent that it enhances the continued operation of underwritten title companies, all of whom are domestic. As noted, to the extent that shifting of liability to the underwritten companies is not limited, a commensurate increase in their capitalization would be required for initial licensing and expansion, thus diminishing market entrance and small business formation and growth within the state. Therefore, in the Commissioner's assessment, this regulatory action is likely to enhance competition which could result in either the increase or elimination of businesses and jobs in California. If there are a loss of jobs and businesses, the extent of such losses should be offset by other improvements in terms of the State's aggregate economic activity. The proposed regulations should not, however, adversely affect new business formation nor significantly impact the expansion of many if not all title businesses already doing business in California.

## **FINDING OF NECESSITY**

The Commissioner finds that it is necessary for the welfare of the people of the state that the regulations apply to businesses.

## **PRESCRIPTIVE STANDARDS VERSUS PERFORMANCE STANDARDS**

The Commissioner proposes the adoption of prescriptive standards as defined in Government Code section 11342.590 rather than performance standards as defined in Government Code

section 11342.570 because the proposed regulations seek to implement the licensure requirements of the Underwritten Title Company statute, Insurance Code section 12389 *et seq.* and related statutes; however the Commissioner invites alternative proposals including proposals of a performance nature.

## **IMPACT ON HOUSING COSTS**

The proposed regulations will have no significant effect on housing costs.

## **ALTERNATIVES**

The Commissioner must determine that no reasonable alternative considered by the Commissioner or that has otherwise been identified and brought to the attention of the Commissioner would be more effective in carrying out the purpose for which this action is proposed or would be as effective and less burdensome to affected private persons than the proposed action, and the Commissioner must consider the substitution of performance standards for prescriptive standards.

## **IMPACT ON SMALL BUSINESS**

The Commissioner has determined that the proposed amendments will affect small businesses to the extent that it affects underwritten title companies. However, insurance companies, which will also be affected, are by definition not small businesses, pursuant to Paragraph (b) (2) of Government Code section 11342.610. This notice will be mailed to underwritten title companies licensed in California.

## **COMPARABILITY AND CONFORMITY WITH FEDERAL LAW**

Under current federal law, the regulation of insurance, including title insurance, is primarily the responsibility of the states. However title insurance entities are also subject to federal law specifically the “Real Estate Settlement Procedures Act” or “RESPA.” See 12 U.S.C. § 2601 *et seq.* Under federal law, California law in general is not annulled, altered, affected or exempted by RESPA, except to the extent California laws are inconsistent with federal law, and then only to the extent they are inconsistent and the inconsistency does not provide greater protections for the consumer as specified. See 12 U.S.C. § 2616. The proposed regulations are not inconsistent with applicable federal law.

## **TEXT OF REGULATIONS AND STATEMENTS OF REASONS**

The Department has prepared an initial statement of reasons that sets forth the reasons for the proposed action. Upon request, the initial statement of reasons will be made available for inspection and copying. Requests for the initial statement of reasons or questions regarding this proceeding should be directed to the contact person listed above. Upon request, the final

statement of reasons will be made available for inspection and copying once it has been prepared. Requests for the final statement of reasons should be directed to the contact person listed above.

The file for this proceeding, which includes a copy of the express terms of the proposed regulations, the statement of reasons, the information upon which the proposed action is based, and any supplemental information, including any reports, documentation and other materials related to the proposed action that is contained in the rulemaking file, is available by appointment for inspection and copying at 45 Fremont Street, 24th Floor, San Francisco, California 94105, between the hours of 10:00 a.m. and 4:30 p.m., Monday through Friday.

### **AUTOMATIC MAILING**

A copy of this notice, including the informative digest, which contains the general substance of the proposed regulations, will automatically be sent to all persons on the Insurance Commissioner's mailing list.

### **WEBSITE POSTINGS**

Documents concerning this proceeding are available on the Department's website. To access them, go to <http://www.insurance.ca.gov>. Find at the right hand side of the page the heading 'QUICK LINKS.' The third item in this column under this heading is 'For Insurers'; on the drop-down menu for this item, select 'Legal Information.' When the 'INSURERS: LEGAL INFORMATION' screen appears, click the third item in the list of bulleted items near the top of the page: 'Proposed Regulations.' The 'INSURERS: PROPOSED REGULATIONS' screen will be displayed. Select the only available link: 'Search for Proposed Regulations.' Then, when the 'Search or Browse for Documents for Proposed Regulations' screen appears, you may choose to find the documents either by conducting a search or by browsing for them by name.

To search, enter "REG-2009-00019" (the Department's regulation file number for these regulations) in the search field. Alternatively, search using as your search term the Office of Administrative Law's notice file number assigned to the regulations ("Z-2009-0811-03"), or search by keyword or term ("Underwritten Title Company Liability Limitation," for example, or "underwriting agreement"). Then, click on the 'Submit' button to display links to the various filing documents.

To browse, click on the 'Browse All Regulations' button near the bottom of the screen. A list of the names of regulations for which documents are posted will appear. Find in the list the 'Limitation on Underwritten Title Company Liability' link, and click it. Links to the documents associated with these regulations will then be displayed.

### **MODIFIED LANGUAGE**

If the regulations adopted by the Department differ from those which have originally been made available but are sufficiently related to the action proposed, they will be available to the public



for at least 15 days prior to the date of adoption. Interested persons should request a copy of these regulations prior to adoption from the contact person listed above.